Lifetime Income

Making Your 401(k) Last a Lifetime

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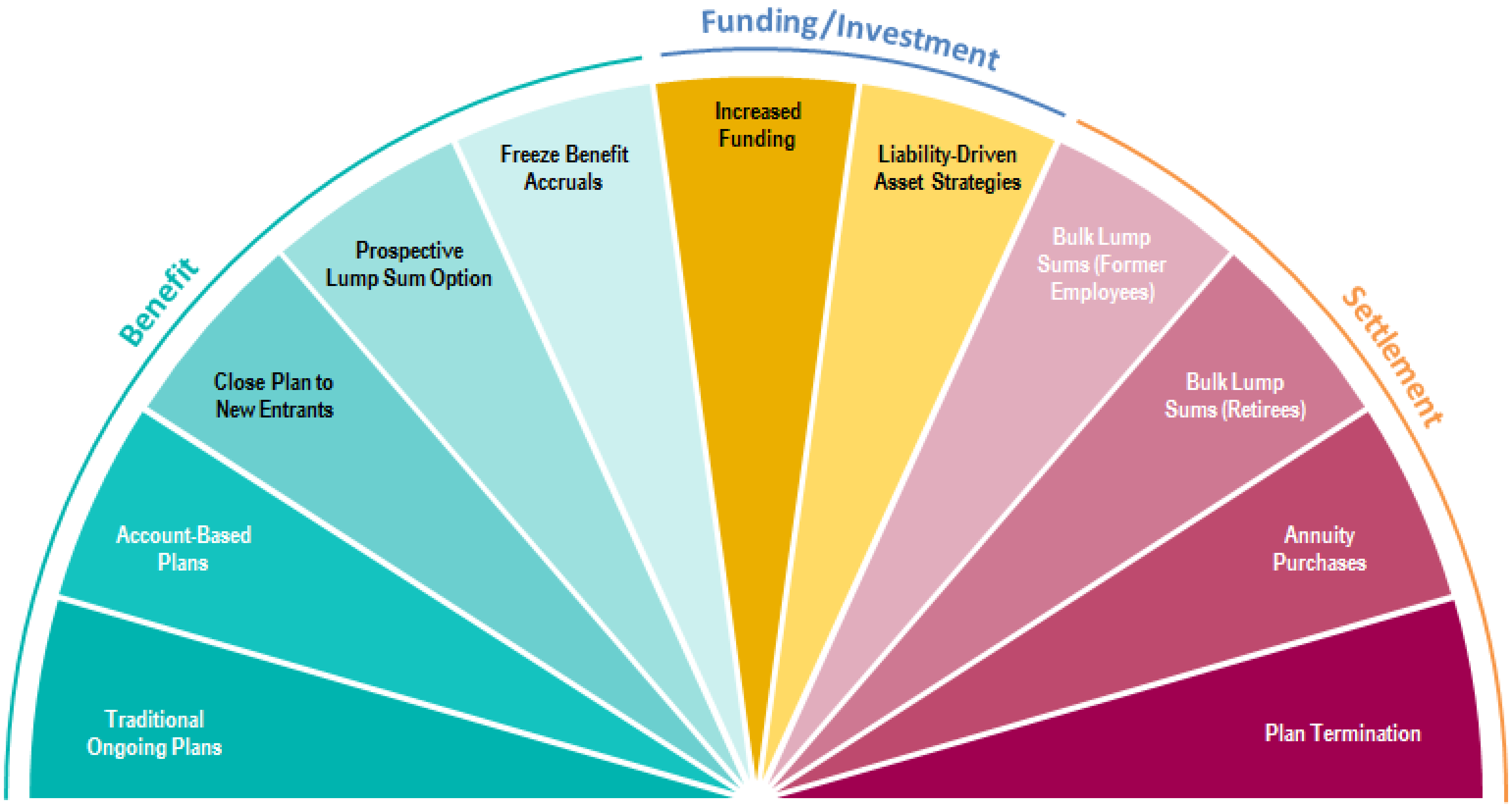
Overview

- Employer trends around life-time income
- Taking advantage of opportunities with Social Security
- What we know and where we go from here

Evolution across all elements of pension risk management



Spectrum of Pension De-Risking Actions

Employers move away from managing long-term obligations

De-risking activities among large DB sponsors

- **Two-thirds** of Fortune 500 companies that offered a pension to new hires in 1998, no longer offer such benefits today.
- **75%** have or expect to have a de-risking plan in place by end of 2015.
- **50%** indicate they have a long-term objective of settling some or all liabilities of which **76%** expect to do so within next 10 years.

Pension liability management and settlements among the largest DB sponsors

- In 2014, **23** of the largest 100 US DB sponsors took action to reduce pension obligations.
  - **22** offered bulk lump sum offerings to terminated vested participants or retirees, reducing obligations by $9 billion.
  - **2** enacted annuity purchases(one offered BLS as well) to a 3rd party insurer, reducing obligations by $4.5 billion.
- So far in 2015, **3** additional companies have started the process of transferring some of their liabilities to a 3rd party insurer.

Life-time income distributions in Defined Contribution Plans

- Take-up rates remain fairly low for lifetime income offerings. Only **12%** of DC sponsors offer life-time income distribution options. For those that never offered a DB or have frozen a pension, only **9%** offer life-time income options in their DC plan.
- When offered to participants, the vast majority of plan sponsors report a **5% or less** take up rate.
- For those sponsors that do not offer life-time income options in DC plans, **'lack of participant demand' and 'fiduciary risk'** were the largest deterrents to providing these retirement distributions vehicles.

Literature on Social Security optimization suggests potential opportunity for expanded annuitization

- Mahaney, James I., and Peter C. Carlson, "Rethinking Social Security Claiming in a 401(k) World," in John Ameriks and Olivia S. Mitchell, eds., Recalibrating Retirement Spending and Saving (Oxford; Oxford University Press, 2008), pp. 141-167.

- Meyer, William, and William Reichenstein, "Social Security: When Should You Start Benefits and How to Minimize Longevity Risk?" Journal of Financial Planning (March 2010), pp. 52-63.

- Shoven, John B., and Sita Nataraj Slavov, "Recent Changes in the Gains from Delaying Social Security," NBER Retirement Research Paper No. NB 13-04 (November 2013), found at: http://www.nber.org/aging/rrc/papers/orrc13-04.

Social Security claiming deferral: opportunity and challenge

Opportunity:

Today: Benefit = 75% if PIA @ 62 → 132% of PIA @ 70, a 76% ↑

Tomorrow: Benefit = 70% if PIA @ 62 → 132% of PIA @ 70, an 86% ↑

Challenge:

- Developing a general understanding the opportunity and benefits
- Mechanisms to facilitate deferred claiming
  - Structured accumulation
  - Bridge income vehicles

Consider workers born in 1942, retiring claiming Social Security at age 62 in 2004

- What if they had saved 6 percent of pay each year from age 21 through age 61?

- Invested 60 percent in U.S. equities and 40 percent in bonds each year and rebalanced portfolio each year

- Incurred investment and administration costs of 25 basis points per year

- Still retired at age 62 but used a share of retirement savings as bridge income equal to Social Security benefits in order to defer claiming

Integrated benefits from deferring Social Security from age 62 to 70 and using defined contribution savings to finance a bridge income during delay

	AIME Deciles		
Single Worker	**2**	**6**	**10**
Gross saving	$155,617	$311,816	$438,094
Bridge reduction	$91,326	$144,550	$171,464
Share used for bridge	58.7%	46.4%	39.1%
Social Security gain	$100,953	$159,786	$189,537
Net cash gain from deferral	$9,627	$15,237	$18,074
Commercial annuity value of Social Security gain	$128,064	$202,697	$240,438
Annuity gain net of bridge reduction	$36,738	$58,148	$68,974
Percent total gain relative to bridge reduction	40.2%	40.2%	40.2%

Integrated benefits from deferring Social Security from age 62 to 70 and using defined contribution savings to finance a bridge income during delay

	AIME Deciles		
One-earner Couple	**2**	**6**	**10**
Gross saving	$155,617	$311,816	$438,094
Bridge reduction	$133,090	$212,057	$251,540
Share used for bridge	85.5%	68.0%	57.4%
Social Security gain	$180,076	$285,021	$338,090
Net cash gain from deferral	$46,986	$72,964	$86,549
Commercial annuity value of Social Security gain	$215,218	$340,643	$404,069
Annuity gain net of bridge reduction	$82,128	$128,587	$152,528
Percent total gain relative to bridge reduction	61.7%	60.6%	60.6%

Additional results

- The potential gains for two-earner couples in relative terms were comparable to those for single workers
- The net benefits from deferring would have been even greater for workers retiring in 2001 at age 62 and claiming at age 70 in 2009 after equity markets had hit bottom in 2008
- Deferring from age 62 in 1991 and claiming at age 70 in 1999 would have resulted in net loss but real net outcomes are only known in hindsight
  - In retrospect, investing all savings in equities would have maximized wealth by 1999
  - But that does not mean diversification was not the appropriate strategy for savers to follow in 1991

What we know

- Employers have been moving away from providing annuity benefits for career workers
- Trend is almost certainly not reversible
- Retirees are not willing to buy conventional annuities to the extent many believe is desirable
- Financial well-being is gaining more attention from employers
- Existing Social Security structure provides an opportunity but workers need mechanisms to take advantage of it
- Uncertainty about Social Security financing should be resolved if this is to become a real viable alternative for the future